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From: David E. Janssen
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**LEGISLATIVE ANALYST'S OFFICE (LAO) ANALYSIS OF THE GOVERNOR'S
FY 2003-04 BUDGET**

On January 10, 2003, Governor Davis released his Proposed Budget for FY 2003-04 which is intended to close a \$34.6 billion budget gap projected for the remainder of the current year, as well as the budget year. In addition, the Governor indicated that his proposal addressed the structural budget deficit – the recurring gap between spending requirements and the revenues available – which the Legislative Analyst (LAO) had estimated to be between \$12 billion to \$16 billion annually through FY 2007-08.

On February 19, 2003, the LAO released its detailed *Analysis of the 2003-04 Budget Bill*, as well as its related policy analysis, *The 2003-04 Budget: Perspectives and Issues*. The following report is based on both documents with primary focus on some of the major issues which underpin the Governor's proposal, as well as on the LAO's recommendations regarding specific issues of interest to the County.

The Size of the Budget Problem

The Governor's budget addressed a \$34.6 billion budget, considerably larger than any of the previous estimates, including the LAO's November 2002 estimate. Instead of providing a new estimate of the size of the budget problem, the LAO's analysis starts from the base line of the Governor's proposal and makes adjustments to account for its assumptions about the economy and revenues, as well as its estimates of spending. Because the LAO is slightly more optimistic about economic growth in the budget year, it is projecting about \$1.3 billion more revenue than the Governor, offset by \$273 million in spending not included in the Governor's budget. In short, the LAO and the Administration are in substantial agreement about the size of the State's budget problem.

Does the Governor's Budget Solve the Problem?

According to the LAO, the Governor's budget would solve both the short and long term fiscal imbalance in the State budget. If approved by the Legislature as proposed, the State would end the budget year with a \$1.6 billion reserve which would grow to \$2.3 billion in FY 2003-04. The budget's structural deficiency – now estimated at \$18 billion by the LAO – would also be cured. However, as the LAO is quick to point out, two complex and/or controversial proposals account for much of the budget solution: the elimination of the base VLF local backfill and a major realignment of State-county programs financed by an \$8.3 billion tax increase. If either, or both, of these proposals prove to be unacceptable to the Legislature, it would be necessary to replace them “with alternative solutions of similar magnitude” or the proposed budget solution falls apart. In addition, the LAO notes that there are serious risks to some of the Governor's budget assumptions, especially the \$1.5 billion of new revenue from Indian gaming.

As it did last year, the LAO advises the Legislature to reduce State spending as quickly as possible to reduce the cuts otherwise needed in the budget year, to put “everything on the table” including program reductions as well as tax increases, and ensure that the adopted budget addresses the structural deficiency as well as the budget year shortfall.

State Appropriation Limit

In view of the current interest in a State spending cap, it is noteworthy that the proposed budget is \$6 billion below the existing appropriation limit established by the voters in 1979, adjusted for population growth and an inflation factor. In FY 2002-03 it was \$15 billion below the limit.

Proposition 98 Minimum Guarantee for Schools

The Governor's mid-year budget reductions proposed in December would have reduced the current year Proposition 98 appropriation by \$2.6 billion to the minimum required. The proposed budget exceeds the minimum by \$104 million. The current year budget reductions approved by the Legislature in January represent a decrease of only \$1.6 billion, much of it from deferred spending. In the face of the Legislature's historic reluctance to cut school spending, the LAO stresses the need to make real cuts, not just deferrals which will grow to \$2.8 billion if the January budget reductions become law.

Transportation Funding

In 2000, the Legislature enacted the Traffic Congestion Relief Program (TCRP) to develop a six-year plan (later extended to eight years) to address state and local

transportation needs. However, as the State budget worsened, \$1.3 billion of these funds were loaned to the General Fund. The proposed budget would transfer an additional \$100 million, forgive a \$500 million loan repayment scheduled for the budget year, and suspend the transfer of \$1.1 billion in sales tax revenue from the General Fund. According to the LAO, the consequences of these actions will be disruptive to projects already under way, as well as to newly executed contracts. Moreover, uncertainty about future funding makes it impossible to plan. Consequently, the LAO recommends that the Legislature clarify the situation by stating that these actions amount to one-time suspension, or by ending the TCRP, or by promising to repay the borrowed funds, or by approving a 3 cent gas tax increase as replacement revenue.

The Governor's Tax Proposal

The Governor's tax proposal consists of three components: a 1 cent increase in the sales and use tax rate, new high-income personal income tax brackets, and a \$1.10 per pack increase in the cigarette excise tax. The combined revenue from all three components in the budget year would be \$8.3 billion, of which \$8.2 billion would be used to fund the Governor's realignment proposal. While the sales tax increase would impact all Californians, the other two proposals would impact far fewer taxpayers with the income tax increase affecting an estimated 4 percent of the taxpayers.

By dedicating virtually all of the new revenue to realignment, the Governor is able to avoid having to share approximately one half of it with schools under the requirements of Proposition 98, which would reduce the revenue available for the budget solution. However, the LAO points out that there are other options to achieve the same outcome, including a one-time suspension of Proposition 98 or earmarking existing revenue for realignment. According to the LAO, "a one-time suspension of Proposition 98 would not materially alter future state education funding obligations under Proposition 98 relative to what the state's funding obligation would have been without new taxes."

Because the Governor's tax proposals would be used to fund a major realignment of State-county programs and responsibilities, the LAO's assessment of each of the taxes is of interest. In the last decade, the sales tax has shown steady growth and moderate volatility, the income tax strong growth but high volatility (although the LAO thinks the worst has passed), and the cigarette tax will continue to decline. In the aggregate, the projected growth rate for the three taxes over the next five years is 5.5 percent to 6 percent annually compared to 7 percent to 8 percent expenditure growth for the programs proposed for transfer. The LAO points out that this is likely to be a problem for counties, given their limited capacity to raise revenue, so that a way to deal with shortfalls must be developed if realignment is to work.

As in the past, the LAO discusses a number of other revenue options that the Legislature might wish to consider, either to fund realignment or to address the budget gap, including a 5 percent income tax surcharge on all taxpayers (\$1.5 billion) and the extension of the sales tax to selected services.

Realignment

The LAO calls realignment the “centerpiece of the administration’s spending plan...” While realignment may appeal to some as a way around Proposition 98 or a way to justify new taxes, the LAO clearly believes in the merits of realignment, although it warns that it will not be easy to achieve and some of the changes would need to be phased in over several years.

The LAO begins with the question: What programs would be better if they were realigned? The LAO then proceeds to a preliminary assessment of the programs proposed by the Governor as well as additional candidates that they have identified. The attached table (Attachment I) contains the results of their assessment, indicating the programs they believe should be considered or removed by the Legislature. The LAO’s total of \$9.1 billion (\$5.1 billion from the Governor and \$4.0 billion of their own) compares to the Governor’s \$8.2 billion.

In general, the LAO stresses the need to maximize local control to improve the delivery of services, guarantee accountability, and allow for adjustments in funding based on diverse needs or revenue shortfalls. However, the LAO recognizes that may not be possible for all programs, in which case they suggest the need for two pools of funds – one for programs that the State (or Federal) government would control and guarantee full funding and the other which would be similar to a block grant over which counties would have broad discretion. In addition to suggesting the need to consider a reserve to deal with funding shortfalls, the LAO suggests that the Legislature consider providing a local revenue option to supplement the new revenues.

Of special interest to counties, especially Los Angeles County, the LAO recommends 13 of the State’s ongoing mandates (for which funding is currently deferred) for inclusion in realignment, including those relating to voting, property tax administration and mental health/special education (AB 3632). In addition, Early and Periodic Screening, Diagnosis and Treatment is recommended for realignment.

The LAO’s summary of their analysis is attached (Attachment II). The full report can be found at www.lao.ca.gov. An analysis of specific issues that impact the County follows.

COUNTY ISSUES

General Government

SB 90 Reimbursement. The Governor proposes to continue the deferral of local government reimbursement for State mandates indefinitely, which will result in a net cost to the County of approximately \$60 million in FY 2003-04, on top of a \$150 million deferral for the current and prior years. As noted above, the LAO recommends that some of the major county mandates be funded under realignment. In addition, the LAO suggests that if mandates are not funded, the Legislature should eliminate the State's liability by repealing the mandate, or modify it to make it optional, or allow local governments to offset their costs through fees or program-related savings, or suspend the mandate for the budget year. The LAO recommends suspension or repeal, and also recommends that the 26 currently suspended mandates be eliminated.

Regional Housing Element Mandate. Every city and county must prepare a housing element as part of its general plan to assess its housing stock and develop a five-year plan for housing development, including "affordable housing. Currently, only 56 percent of the housing elements are in compliance. According to the LAO, the cost to the State to achieve this level of compliance is \$9.9 million, about three times greater than anticipated. Because of the wide variation in the costs submitted to the State for reimbursement by cities, counties and regional councils of governments and the fact that costs are reimbursed even when a plan is not in compliance with State law, the LAO recommends that this mandate be eliminated for cities and counties and suspended for regional councils of governments until the entire process can be reformed.

Federal Child Support Penalty. The Governor proposes to assess counties 25 percent of the cost of the Federal penalty imposed because the State's automated system continues to be out of compliance with Federal requirements. The assessment would be collected starting in the last quarter of the current year, costing counties \$6.2 million in the current year and \$52 million in the budget year. The LAO did not comment on the Governor's recommendation.

Health

Medi-Cal: Eligibility. The LAO does not support the \$41 million in additional funding recommended in the Governor's Budget for the cost of county eligibility re-determination. Instead, the LAO recommends that the Legislature direct the Department of Health Services to adopt workload or productivity standards for county Medi-Cal workers, authorize additional State staff to monitor counties and take corrective action if a county fails to meet the standards, and link a county's level of

funding to its performance. Further, the LAO suggests that the Legislature consider realigning a portion of State costs for eligibility administration to counties instead of shifting 15 percent of Medi-Cal benefit costs and revenues.

Medi-Cal: Disease Management. The LAO suggests that poor management of treatment for persons with chronic diseases such as asthma, diabetes, and heart disease, is driving up the State's costs for Medi-Cal. The implementation of a disease management program to encourage individuals to take better care of their chronic health conditions could eventually reduce State expenditures by hundreds of millions of dollars annually. The LAO recommends legislation to guide the implementation and evaluation of disease management pilot projects for the aged, blind, and disabled patients enrolled in fee-for-service Medi-Cal.

Shift Eligible Veterans from Medi-Cal to Veterans Administration (VA) Benefits. The LAO recommends that the Legislature direct DHS to examine whether veterans constitute a significant portion of the Medi-Cal Program caseload. Because Federal survey data suggest that there may be tens of thousands of military veterans who could be receiving comprehensive medical services from the VA health care system rather than through Medi-Cal, the LAO indicates that it is possible that the State could save as much as \$250 million annually.

CHDP Program Reform. The Budget reduces funding by \$80.6 million for the Child Health and Disability Prevention Program (CHDP), which provides childhood screening and immunizations to low-income children. However, the Budget includes \$283.9 million (\$137.1 million General Fund) to use CHDP as a gateway to streamline enrollment into Medi-Cal or the Healthy Families Program. The LAO concurs with the Governor's recommendation.

California Children's Services. The LAO recommends that the Legislature can improve the operation of the California Children's Services program by requiring counties to screen for CCS children for Healthy Families Program eligibility (\$5 million savings); requesting the Bureau of State Audits to examine whether counties are appropriately billing the State under Medi-Cal for medical therapy services; and shifting medical therapy costs to Proposition 98 (\$37 million estimated savings).

Consolidation of Aging Programs. Citing overlapping missions, the LAO recommends elimination of the California Department of Aging and consolidation of all aging programs in the Department of Social Services, for an estimated savings of \$3.4 million. Area Agencies on Aging would continue to coordinate and deliver services to senior citizens on the local level.

Mental Health

See the discussion of Realignment above for LAO proposals impacting Mental Health.

Social Services

ChildCare. The LAO is supportive of the Governor's proposal to include child care in realignment by transferring responsibility for child care and development programs administered by the State Department of Education to counties.

CalWORKs Time Limit Savings. The LAO withheld its recommendation on the estimated savings from CalWORKs due to time limits pending review of the Governor's May Revise.

CalWORKs Caseload. The LAO recommends that proposed spending for CalWORKs grants be reduced by \$250 million (TANF funds) in FY 2002-03 and \$100 million in FY 2003-04 because the Administration's caseload estimate is overstated, and suggests that the savings from lower caseloads be used to increase the TANF reserve to \$550 million.

CalWORKs Grants. The LAO recommends a technical adjustment to capture more savings but otherwise is silent about the Governor's proposal to reduce CalWORKs cash grants by approximately 6 percent from the level in the FY 2002 Budget Act and eliminate the cost-of-living adjustment.

CalWORKs Performance Incentives. No funds are budgeted for Performance Incentives for FY 2003-04 which the LAO notes will result in an obligation to repay \$394 million to counties.

Food Stamps. The LAO notes that the Federal Farm Bill will restore food stamp eligibility to over 90 percent of the persons eligible for benefits under the California Food Assistance Program. It withheld recommendations on the cost of reprogramming associated with implementing recent Federal eligibility and other changes pending review of the Governor's May Revise.

The LAO recommends that the State Department of Social Services (SDSS) report at budget hearings on: 1) the status of its negotiations with the Federal government on its proposed prospective budgeting system for the Food Stamps and CalWORKs programs; and 2) the cost implications associated with alternative approaches to prospective budgeting. AB 444 (Arner) of 2002 required SDSS to implement a quarterly reporting system for both the CalWORKs and Food Stamps programs. The FY 2002-03 Budget Act assumed that this "prospective budgeting" system would be

implemented by April 1, 2003 but there has been a delay in Federal approval of California's prospective budgeting proposal.

In-Home Supportive Services (IHSS). The LAO indicates that the Governor's proposal to suspend the IHSS revenue "trigger" for State participation in higher wages for public authority counties would only impact program costs if the Legislature rejects the Governor's proposal to realign IHSS to counties, and revenue growth in FY 2003-04 is greater than 5 percent. The LAO recommends that the Legislature's action on this issue be consistent with its action on IHSS realignment.

Child Welfare Services (CWS). The LAO recommends that the Legislature maintain CWS case-management funding per child at its FY 2002-03 level, which would reduce General Fund spending by \$11 million. The LAO indicates this would not reduce the level of care and services because the proposed budget does not reflect savings from projected caseload declines. The LAO also recommends that SDSS adopt a method of budgeting for CWS that reflects trends in actual caseload.

The LAO acknowledges that a CWS Workload Study found that CWS caseworkers are overburdened and carrying much larger caseloads than are ideal. To address this issue, the Legislature has separately budgeted "augmentations" to CWS. The LAO recommends that if the Administration decides to move toward the updated standards outlined in the study, it should do so through a proposed augmentation, budgeted separately from the basic workload.

Furthermore, the LAO recommends that SDSS abolish the hold-harmless method of budgeting the basic CWS workload. In preparing the budget for CWS, the SDSS adjusts proposed funding upward when the caseload increases, but does not adjust funding downward when the caseload actually decreases.

Department of Child Support Services (DCSS). The LAO indicates that the DCSS budget for county administration is based on estimated collections rather than estimated county costs and does not reflect recent initiatives to improve program performance. The LAO recommends that DCSS revise its budget to separate the funding for basic administration from program initiatives and base the core administrative budget on actual county expenditures, estimated workload changes, and any increases in the cost of doing business.

Resources and Environmental Protection

Natural Resources. The LAO recommends additional opportunities to shift funding from the General Fund to fees, resulting in a potential savings of \$214 million. In addition, it emphasizes the need for the Legislature to better define and guide the

implementation of bond funded programs through legislation. The LAO recommends a \$100 million reduction in various water-related activities funded by Proposition 50 so that the Legislature can provide oversight and guidance for these programs through legislation. Similarly, the LAO recommends deleting \$32.4 million in proposed funding from Propositions 40 and 50 for river parkway projects. However, the LAO recommends approval of the historical and cultural portion of Proposition 40, for which \$98 million is proposed in the FY 2003-04 budget because its purpose and implementation was well defined in AB 716 (Firebaugh).

CALFED. The proposed budget provides \$497 million for the CALFED Bay-Delta Program, which could provide grants for local water conservation, environmental restoration and dam security projects. While the LAO recommends legislation to ensure that prior direction from the Legislature is followed, it does not recommend any changes in the funding level.

Environmental Protection. The LAO recommends a \$4.4 million increase to \$14.4 million in the amount of General Fund costs for air quality programs that the Governor proposes to shift to fees.

Justice

Realignment. The LAO recommends that the Legislature consider Juvenile Justice, Adult Parole, COPS and Juvenile Justice Challenge Grants for inclusion in realignment.

Juvenile Crime Prevention Program. The LAO supports the Governor's recommendation for full funding.

Elderly Inmates. The LAO recommends the early release of elderly inmates for a \$9 million savings.

Inmates' Work Credits. The LAO recommends legislation to allow an inmate to earn work credits faster to achieve an earlier release for a savings of approximately \$70 million.

Court Security. The LAO recommends that the Legislature reject the Governor's proposal to include court security within realignment. However, the LAO recommends that the courts be required to use competitive bidding. The LAO cites Los Angeles County as an example of how the courts could save 71 percent, or \$74 million, if they used private industry.

Undesignated Fees. The LAO agrees with the Governor's proposal to shift these fees from the counties to the courts. Counties will lose approximately \$31 million.

Crime Lab Fees. The LAO supports the Governor's proposal to require local law enforcement agencies to pay for analysis of crime evidence.

Judicial

State Trial Court Funding. The Budget assumes a security fee of \$20 per court filing and a \$10 increase in the trial motion fee. The LAO is concerned that these increases could reduce access to the courts.

We will continue to keep you advised.

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Attachments

c: Executive Officer, Board of Supervisors
 County Counsel
 Local 660
 All Department Heads
 Legislative Strategist
 Coalition of County Unions